

IS BANK SECRECY STILL BANKABLE?: A CRITICAL REVIEW OF BANK SECRECY LAW, TAX EVASION AND UBS

JACLYN H. SCHOTTENSTEIN^{*}

I. INTRODUCTION

Switzerland – the land of fine chocolates and precision timepieces – is well known for its martial neutrality.¹ But, in 2009, as world markets teetered on the brink of a global financial meltdown, Switzerland found itself enmeshed in an international legal drama centering on what some would cite as the most prominent feature of Switzerland's political-economic constitution: bank secrecy. The dispute pitted United States tax law against a well-established and fiercely protected tenet of Swiss law. On the one side, the U.S. Department of Justice demanded Swiss-based UBS AG (UBS) release the names of 52,000 Americans suspected of establishing private Swiss bank accounts for the purposes of evading taxes;² and on the other, Switzerland sought to uphold its 300-year-old time tested practice of guaranteed secrecy for Swiss banking clients.³

The right to tax, and, by extension, the right to control the taxation of economic activity inside one's national borders, comprises the very essence of national sovereignty.⁴ Over the past 30 years, in response to growing demand for offshore financial services, dozens of countries have established themselves as jurisdictions of advantageous tax treatment (JATTs).⁵ JATTs offer attractive terms and/or enhanced privileges for

^{*} Juris Doctor, The Ohio State University Moritz College of Law, expected 2011.

¹ Helena Bachmann, *U.S. vs. UBS: A Fight Over Secret Swiss Bank Accounts*, TIME, July 15, 2009, available at <http://www.time.com/time/printout/0,8816,1910389,00.html>.

² See, e.g., Kevin McCoy, *U.S. wants names of 52,000 customers of Swiss bank UBS*, USATODAY, Feb. 19, 2009, http://www.usatoday.com/money/industries/brokerage/2009-02-18-ubs-settles-sec-charges_N.htm.

³ Historical Origins of Swiss Bank Secrecy, <http://switzerland.isyours.com/E/banking/secrecy/history.html> (last visited Oct. 30, 2009).

⁴ CHRIS EDWARDS & DANIEL J. MITCHELL, GLOBAL TAX REVOLUTION: THE SIDE OF TAX COMPETITION AND THE BATTLE TO DEFEND IT 175 (2008).

⁵ See STAFF OF S. COMM. ON THE PERMANENT SUBCOMM. ON INVESTIGATIONS, 110TH CONG., REPORT ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE (Comm. Print 2008), available at

foreign citizens utilizing financial products and/or services within the JATT's political boundaries and typically provide for either nominal or no taxation of assets transferred to their financial institutions by foreign citizens.⁶ This escalation in demand has been attributed to a confluence of factors, which include: (1) increased levels of taxation and expanded regulatory authority in many industrialized nations; (2) political instability and general legal and regulatory uncertainty in certain emerging markets; (3) the rise of multinational corporations, whose primary stated allegiance is to shareholders rather than to any particular sovereign body; (4) the expansion of world trade, cross border investment and transactions, and globalization, which can obfuscate claims to tax revenue; and (5) an increase in both personal and corporate wealth, which has driven both the need and capacity for complex financial planning and extra-national investment programs.⁷

In the wake of rising national deficits and encroaching budgetary constraints, certain industrialized nations have exhibited renewed resolve to mitigate tax evasion following decades of more lenient postures towards both JATTs and those who utilize them.⁸ Though JATTs have long been identified as sources of concern for those seeking to prevent tax evasion and curb international money laundering,⁹ the recent global financial crisis has provided fresh political impetus to heed longstanding calls for increased regulation of offshore financial centers (OFCs) and other JATTs.¹⁰ Consequently, certain countries – specifically those standing to benefit most substantially from the recapture of lost tax revenue resulting from its citizens' reduced abilities to shield assets from taxation – have demonstrated a markedly increased willingness to engage in coordinated, united action to reduce the abilities of JATT based financial institutions to knowingly or unknowingly facilitate tax evasion by citizens otherwise

http://hsgac.senate.gov/public/_files/071708PSIRreport.pdf.

⁶ *Id.*

⁷ See Welcome to Offshore Exclusive, <http://www.offshoreexclusive.com> (last visited Oct. 30, 2009).

⁸ See David R. Francis, *A Tougher Stance on Tax Havens*, THE CHRISTIAN SCIENCE MONITOR, Aug. 19, 2009, at 6.

⁹ Yishian Lin, *Taiwan's Right to Tax*, PRICEWATERHOUSECOOPERS TAIWAN, <http://www.pwc.com/tw/en/challenges/taxation/indissue0261.jhtml> (last visited Feb. 1, 2010).

¹⁰ Orlando Fernández, *International Regulation of Offshore Financial Centres: Recent Developments in the Field of Tax Information Exchange*, CBQ 5, at 5 (Oct.-Dec. 2009), <http://crossborder.practicallaw.com/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1247492072626&ssbinary=true>.

subject to domestic taxation.¹¹ As a result of such coordinated efforts, the regulatory regime policing JATTs is likely to undergo significant structural revisions aimed at improving the stability of the U.S. and world economies. Such changes hold the potential to substantially redefine the scope and reach of JATTs and OFCs.

This Note examines the key legal issues raised by the UBS tax evasion case and the likely impact of this historic legal challenge to Swiss banking secrecy. Additionally, this Note highlights key distinctions between JATTs that enhance the function and efficiency of global markets by promoting competition among sovereign tax setting bodies and those that through bank secrecy laws provide foreign citizens a ready means of sheltering assets from the purview of their domestic tax regimes.¹² As we shall see, sovereign bodies may impose competitive rates of taxation in order to encourage business activity and commercial development,¹³ but may not be permitted (either directly or indirectly through entities within their jurisdictions) to counsel, aid and/or abet individuals seeking to bypass and/or violate the laws of their home countries.¹⁴ Finally, to illustrate these issues in a real world context, this Note presents the UBS-U.S. case history, which demonstrates the means by which a Swiss bank has employed banking practices, which were later deemed to have facilitated tax evasion by certain of its U.S. clients.

II. OFFSHORE FINANCIAL CENTERS

A. *Offshore Financial Centers (OFC)*

1. *Overview*

While there exists no single accepted definition for OFCs, for the purpose of this Note, an OFC shall be understood to mean: “Any country or jurisdiction with a financial center that contains (1) a relatively large number of financial institutions engaged primarily in business with non-residents; (2) financial systems with external assets and liabilities out of unusually high proportion to domestic financial intermediation designed to finance domestic economies; or (3) centers which provide some or all of the

¹¹ See REPORT ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE, *supra* note 5, at 18.

¹² *The Kudlow Report: IRS Offshore Crackdown* (CNBC television broadcast Aug. 2009), available at <http://www.cnbc.com/id/32491581>.

¹³ *Id.*

¹⁴ *Id.*

following services: low or zero taxation; moderate or light financial regulation; banking secrecy and anonymity.”¹⁵

OFCs range from centers with well-developed financial markets and infrastructure, such as Hong Kong and Singapore, to centers with smaller populations, such as the Cayman Islands, the British Virgin Islands and the Bahamas.¹⁶ They afford legitimate and important services in three primary business units: (1) private investments, in which investments are strategically managed to minimize tax liabilities and maximize protection granted in accordance with statutory confidentiality provisions; (2) asset protection, in which an individual’s assets and income are protected by a foreign international jurisdiction from political, fiscal and legal risks; and (3) estate planning, in which the management of assets is completed in a favorable legal and fiscal jurisdiction.¹⁷ Additionally, other services provided by OFCs include fund and asset management, insurance, trust management, tax planning, and international business corporation (IBC) activity.¹⁸ Switzerland is currently the world leader in offshore wealth management with a global market share of twenty-seven percent.¹⁹

2. *Reasons to Establish an OFC*

Jurisdictions establish OFCs for a number of reasons, including: (1) increasing access to international capital markets; (2) attracting foreign technical proficiency and skills; (3) raising employment levels; (4) increasing government revenue through licensing and/or certification fees; and (5) initiating competition in the domestic financial system.²⁰ Certain OFCs, such as the Cayman Islands and the Channel Islands, rely on OFC related business to boost government revenues and strengthen economic activity.²¹ The Island of Jersey realizes approximately 80 percent of its

¹⁵ See IMF MONETARY AND EXCHANGE AFFAIRS DEPARTMENT, OFFSHORE FINANCIAL CENTERS IMF BACKGROUND PAPER (2000), <https://www.imf.org/external/np/mae/oshore/2000/eng/back.htm#I>.

¹⁶ See *id.*; See David McFadden, *Another Int’l Firm Seeks Exit from Cayman Islands*, TAIWAN NEWS ONLINE, Feb. 18, 2010, http://www.etaiwannews.com/etn/news_content.php?id=1183101&lang=eng_news&cate_img=35.jpg&cate_rss=news_Business.

¹⁷ Esther C. Suss, Oral H. Williams & Chandima Mendis, *Caribbean Offshore Financial Centers: Past, Present and Possibilities for the Future 4* (IMF Working Paper, May 2002), <http://www.imf.org/external/pubs/ft/wp/2002/wp0288.pdf>.

¹⁸ IMF MONETARY AND EXCHANGE AFFAIRS DEPARTMENT, *supra* note 15, at § 2(A).

¹⁹ SWISS BANKERS ASSOCIATION, BASEL, WEALTH MANAGEMENT IN SWITZERLAND 4 (2009), <http://www.swissbanking.org/20081223-300-bro-wealthmanagement2009-rva.pdf>.

²⁰ IMF MONETARY AND EXCHANGE AFFAIRS DEPARTMENT, *supra* note 15, § 2(A).

²¹ *Id.*

government revenues from taxing and licensing foreign companies²² and its banking sector contributes more than sixty percent of GDP and employs more than twenty-five percent of the Island's working population.²³

OFCs attract financial institutions and investors for several important reasons. These include: (1) more convenient fiscal regimes which lower explicit taxation and increase net profit margins; (2) adequate legal frameworks that preserve the integrity of principal-agent relations; (3) proximity to major financial centers; (4) reputation of the particular OFC; and (5) freedom from exchange controls.²⁴

Unfortunately, certain of these attributes have resulted in OFCs being utilized for illicit purposes. That is, they can attract funds because they provide depositors with a "cloak of anonymity" and the possibility of tax avoidance or evasion.²⁵ Though not necessarily harmful, the ability to deliberately mislabel and hide funds can facilitate severe repercussions in which dictators, terrorists groups and organized crime networks can easily and secretly transfer their wealth around the world.²⁶

3. Relationship Between OFCs and Banking Secrecy

Banking secrecy is most generally present in regimes in which bank employees are legally obligated to keep clients' personal and financial information under strict confidence²⁷ and is a virtually universal theme present across OFCs throughout the world. Since many individuals cite banking secrecy as their foremost concern in selecting banking jurisdictions, OFC based regimes take their duty to protect client information very seriously, to the point that in many jurisdictions, legal prohibitions on the disclosure of information is further buttressed by criminal sanctions, including fines and imprisonment.²⁸

²² Charles Recknagel, *Will G20 Crack Down on Tax Havens?* (Radio Free Europe Radio Liberty, Apr. 1, 2009), http://www.rferl.org/content/Will_G20_Crack_Down_On_Tax_Havens/1566041.html (last visited Feb. 1, 2010).

²³ *Jersey – Overview*, USATODAY.COM, <http://www.usatoday.com/marketplace/ibi/jersey.htm> (last visited Apr. 1, 2009).

²⁴ Recknagel, *supra* note 22.

²⁵ *Id.*

²⁶ *Id.*

²⁷ See Ankur Poddar, Swati Aggarwal & Peeyush Razdan, *The Future of Bank Secrecy and Switzerland 2* (Aug. 11, 2009), available at <http://ssrn.com/abstract=1460713>.

²⁸ Asset Protection Law Center, <http://www.rjmintz.com/bank-secrecy.html> (last visited Feb. 1, 2010).

All countries with central banking systems possess at least minimal forms of banking secrecy – that is, norms, rules and regulations that prohibit sharing client information with unauthorized parties.²⁹ However, the standard of protection afforded by that secrecy – including, what information may be shared, with whom and under what circumstances – varies widely across the globe.³⁰

III. BANKING SECRECY

A. *Banking Secrecy in Switzerland*

Proudly neutral,³¹ the Swiss conception of democracy avows that the State fundamentally exists to serve its citizens.³² Reflecting this concept, the Swiss Constitution emphasizes personal liberties and privacy and censures the erosion of privacy through governmental supervision.³³ The Swiss conception of banking secrecy draws from this standard of personal privacy, interweaving the principle into the very fabric of legal doctrine that governs Swiss society. Although Swiss law does not explicitly define Swiss banking secrecy, according to legal custom, and for the purpose of this Note, Swiss banking secrecy shall be understood to mean: “a banker’s professional obligation to keep in strict confidence all business and affairs related to the financial and personal circumstances of clients and some third parties, to the extent that knowledge of such matters is acquired in the course of business.”³⁴ Despite its broad reach, however, Swiss banking secrecy is not absolute. Rather, it is a singular and discrete rule expressed more generally within the larger body of legal provisions, which comprise Swiss public and private law and, thus, must be evaluated in this context.³⁵

²⁹ See The Future of Bank Secrecy and Switzerland, *supra* note 27, at 2.

³⁰ *Id.*

³¹ *Id.* Switzerland (population 7.6 million) did not join the United Nations until 2002 and does not belong to the European Union or the North Atlantic Treaty Organization. Military service is compulsory, giving the country a standing militia of 220,000. By law, every Swiss resident must have access to a nuclear bunker, at home or in the neighborhood. *Id.*

³² Federal Department of Finance FDF, <http://www.efd.admin.ch/dokumentation/zahlen/00579/00607/00621/index.html?lang=en> (last visited Feb. 1, 2010).

³³ *Id.*

³⁴ DENNIS CAMPBELL, INTERNATIONAL BANK SECRECY 663-99 at 669 (1992).

³⁵ See Federal Department of Finance FDF, *supra* note 32.

1. Origins

Modern Swiss banking secrecy is the product of long-term historical development.³⁶ The Swiss banker's pledge of secrecy dates to the beginning of Swiss banking activity in the sixteenth century, when the concept was introduced as a customary law.³⁷ In an unpublished decision from the sixteenth century, for example, the Swiss Federal Court ruled that a bank was required to observe the secrecy of its client, regardless of whether a special agreement existed.³⁸

In 1934, the violation of Swiss banking secrecy was codified as a crime by the Swiss Parliament in the Federal Act on Banks and Savings Banks ("Bank Act")³⁹ after the French and German governments sought to obtain client information in an effort to prevent capital flight from their respective countries.⁴⁰ Specifically, Article 47(b) of the Bank Act made the divulgence of "any information" relating to the client a criminal offense.⁴¹

³⁶ James G. Steproe Jr., *The "Secret" Swiss Account: End of an Era*, 38 BROOK. L. REV. 384, 384 (1972), available at <http://heinonline.org/HOL/PDF?handle=hein.journals/brklr38&collection=journals&id=404&print=1§ioncount=1&ext=.pdf>.

³⁷ *Id.* at 385.

³⁸ Kurt Mueller, *The Swiss Banking Secret: From a Legal View*, 18 THE INT'L AND COMP. L. Q. 360, 361 (Apr. 1969), available at <http://www.jstor.org/stable/757529>.

³⁹ See generally KPMG, Swiss Federal Law on Banks and Savings Banks, <http://www.kpmg.ch/docs/20090101-BankA.pdf>.

⁴⁰ Alexandre Ziegler et al., *Negotiating over Banking Secrecy: The Case of Switzerland and the European Union* (2005), available at <http://ssrn.com/abstract=830784>.

⁴¹ Article 47(b) of the Swiss Federal Bank Act of November 8, 1934, provides:

Anyone who in his capacity as an officer or employee of a bank, or as an auditor or his employee, or as a member of the banking commission or as an officer or employee of its bureau intentionally violates his duty to observe silence or his professional rule of secrecy or anyone who induces or attempts to induce a person to commit any such offence, shall be liable to a fine of up to 50,000 francs or imprisonment for up to six months, or both.

Lio fédérale sur les banques et les caisses d'épargne [LB] [Swiss Federal Banking Act], Nov. 8, 1934, Recueil systématique du droit fédéral [RO] 952.0, art. 47 (Switz.);

"If the offender acted with negligence he shall be liable to a fine up to 30,000 francs." Trade Dev. Bank v. Cont'l Ins. Co., 469 F.2d 35, 40 n.2 (2d Cir. 1972); The secrecy provisions were not included in the first draft of the law, which mainly concerned administrative matters such as bank supervision. The provisions, found in Article 47(b), were added before passage of the bill due to Nazi authorities'

The primary thrust of the law was reaffirmed in 1984 when seventy-three percent of Swiss voters agreed to preserve the concept of banking secrecy within the country.⁴² However, the Bank Act does not clearly delineate under which circumstances banks have the right or duty to provide information and today, the scope and application of professional obligations stemming from banking secrecy remain primarily a matter of private law.⁴³

2. Swiss Banking Secrecy Coverage

Swiss banking secrecy protects client privacy in accordance with the constitution and laws of Switzerland.⁴⁴ Article 13 of the Swiss Federal Constitution grants every person “the right to receive respect for his/her private and family life.”⁴⁵ This covers privacy regarding financial income and assets, but excludes abuses of a criminal nature.⁴⁶ Accordingly, Swiss bank secrecy covers “all the business relations of the client with the bank.”⁴⁷ This comprises any and all information of either a business or personal nature obtained in connection with the business transactions of and consultations with its clients.⁴⁸ For example, all communications with the bank, even if an account is never actually opened, are protected under banking secrecy provisions.⁴⁹

Under the Bank Act, solely the client can authorize the bank to disclose information.⁵⁰ Article 273 of the Swiss Criminal Code extends the coverage however, and makes it a crime for a bank to divulge information, even after being authorized in a special agreement by the client.⁵¹ Additionally, Swiss banking secrecy coverage of clients perseveres indefinitely, surviving even the closure of accounts and the time at which a bank’s contractual commitments have been fully performed.⁵²

attempts to investigate the assets of Jews and “enemies of the state” held in Switzerland. Mueller, *supra* note 38, at 361.

⁴² Wharton School of the University of Pennsylvania, *The Other Banking Drama: Those Secret Swiss Accounts*, Knowledge@Wharton, Mar. 4, 2009, at 1, <http://knowledge.wharton.upenn.edu/articlepdf/2173.pdf> (last visited Feb. 1, 2010).

⁴³ Mueller, *supra* note 38, at 362.

⁴⁴ Swiss Bankers Association, <http://www.swissbanking.org/en/home/dossier-bankkundengeheimnis/dossier-bankkundengeheimnis-themen-geheimnis.htm> (last visited Mar. 8, 2010).

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ Poddar, *supra* note 27, at 3.

⁴⁸ Mueller, *supra* note 38, at 362.

⁴⁹ Poddar, *supra* note 27, at 3.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

Due to the private law nature of Swiss banking secrecy, a bank may not plead that its obligation to uphold secrecy is in the public interest.⁵³ Swiss law requires that a bank is be able to produce all information relating to a client's transactions for up to ten years, upon request from that client.⁵⁴ In relation to third parties, however, banks are generally prohibited from disclosing facts that are subject to Swiss banking secrecy. This rule encompasses all communications, including those with private persons, government authorities, and third-party banks. Furthermore, with regard to international relations, the Bank Act applies to all subsidiaries and branch offices of foreign banks established in Switzerland and, as such, extend Swiss banking secrecy duties and restrictions applicable to Swiss banks.⁵⁵

3. *Legal Consequences of Violating Bank-Client Confidentiality*

Any violation of the protection afforded in accordance with Swiss banking secrecy – whether negligent or intentional – is punishable by a prison sentence of up to three years or by a fine up to 250,000 Swiss Francs (CHF).⁵⁶ Violation of bank-client confidentiality remains a punishable offense even after the relationship with the clients has ceased.⁵⁷

Statutorily there are two principal laws that protect client privacy: Article 273 of the Swiss Criminal Code and Article 47 of the Bank Act.⁵⁸ Article 273 of the Swiss Criminal Code provides:

Whoever seeks to discover a manufacturing or business secret in order to make it accessible to a foreign official agency or a foreign organization or foreign enterprise or their agents, whoever makes a manufacturing or business secret accessible to a foreign official agency or a foreign organization or private enterprise or their agents, shall be sentenced to imprisonment for up to three years or a fine, in

⁵³ Mueller, *supra* note 38, at 363.

⁵⁴ *Id.*

⁵⁵ *Id.*; Lio fédérale sur les banques et les caisses d'épargne [LB] [Swiss Federal Banking Act], Nov. 8, 1934, Recueil systématique du droit fédéral [RO] 952.0, art. 47 (Switz.), available at <http://www.kpmg.ch/docs/20090101-BankA.pdf>.

⁵⁶ Swiss Bankers Association, *Bank Client Confidentiality*, *supra* note 44. As of March 7, 2010, CHF 250,000 = approximately 233,700.00 USD.

⁵⁷ *Id.*

⁵⁸ Brief for Government of Switzerland as Amicus Curiae, United States v. UBS AG, No. 109CV20423, 2009 WL 1612394, at *10 (S.D. Fla. Apr. 30, 2009).

serious cases, to imprisonment for not less than one year. A fine can be combined with the imprisonment.⁵⁹

Since 1984, there have been twenty-six convictions for violations of Article 273.⁶⁰ Additionally, Article 47 instructs that anyone acting in his capacity as a member of a banking body, as a bank employee, agent or liquidator, or as a member of a body or an employee belonging to an accredited auditing institution, be prohibited from divulging information entrusted to him or of which he has learned because of his position. Since 1993, there have been forty-eight convictions for violations of Article 47.⁶¹ Article 47 of the Federal Act on Banks and Savings Banks provides:

1. Whoever intentionally:
 - a. divulges a secret entrusted to him in his capacity as a management body, employee, mandatory or liquidator of a bank, as an officer or employee of an audit company or that he became aware of in this capacity;
 - b. seeks to induce others to such a violation of professional secrecy shall be sentenced to imprisonment of up to three years or a fine.
2. Where the offender acts through negligence, he or she is liable to a fine for up to CHF 250,000.
3. In the case of a repetition of the offense within five years of the conviction taking full legal effect, the monetary penalty will be a minimum of 45 daily penalty units.
4. Violation of professional secrecy remains punishable after termination of the official relationship or the practice of the profession.
5. Federal and Cantonal regulations concerning the obligation to testify and to furnish information to a government authority remain reserved.
6. Prosecution and judgment of the acts under this provision are the responsibility of the cantons. The general provisions of the Swiss Criminal Code shall apply.⁶²

4. *Limits of Swiss Bank-Client Confidentiality*

⁵⁹ *Id.*, quoting Strafgesetzbuch [StGB] [Criminal Code] Nov. 13, 1998, SR 311.0, art. 273 (Switz.).

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*; See also Strafgesetzbuch [StGB] [Criminal Code] Nov. 13, 1998, SR 952.0, art. 4 (Switz.), available at http://www.admin.ch/ch/d/sr/952_0/a47.html (original German).

A Swiss banker's obligation to respect a client's privacy is subject to overriding provisions of the Swiss Penal Code and, so, is not absolute.⁶³ Specifically, a Swiss bank's obligations to professional secrecy may be lifted and the bank compelled to provide information in (1) cases of civil proceedings; (2) criminal proceedings; (3) matters of debt, bankruptcy, and tax administration; and (4) dealings with foreign authorities.⁶⁴ Ultimately, the decision to maintain or divulge secret information is a question of law; whether a provision of public law overrides the financial institution's primary duty of secrecy. Consequently, it is the responsibility of the courts – not the banks – to determine whether disclosure of account information is warranted.

B. Other Countries with Banking Secrecy

While Switzerland is the world's largest OFC, managing about one-third of an estimated \$7 trillion of worldwide offshore assets, financial centers with banking secrecy laws exist worldwide. The degree of professional secrecy prescribed by banking secrecy laws varies from one jurisdiction to another. Historically, countries in Europe (such as Austria, Luxembourg, Liechtenstein, the Channel Islands, Gibraltar), the Caribbean (such as the Bahamas, Bermuda, Cayman Islands, Turks and Caicos), and Asia Pacific (such as Singapore and Hong Kong) have each established strict banking secrecy laws.⁶⁵ Additionally, because Panama is one of the few countries in the world never to have signed a tax treaty, depositors there limit their risks of statutorily mandated identity exposure.⁶⁶

Recent international pressure has persuaded a number of OFCs to relax their banking secrecy laws.⁶⁷ However, Swiss bankers have confirmed their resolve to preserve Swiss banking secrecy laws despite an

⁶³ Mueller, *supra* note 38, at 364.

⁶⁴ *Id.*

⁶⁵ Poddar, *supra* note 27, at 5. For an updated status of bank secrecy in Europe see: <http://www.reuters.com/article/idUSLO14119520090924>.

⁶⁶ Panama Legal, S.A., http://www.panamalaw.org/tax_information_exchange_agreements.html (last visited Feb. 1, 2010). In Panama, all tax offenses are civil including tax fraud. When one country requests information, relating to a crime there is a principal applied called dual criminality. Dual criminality means that the crime in question must be a crime in the requesting country and in the requested country. The dual criminality provisions provide safeguards to prevent abuses. Since Panama has no crimes pertaining to taxes, this is not an issue in Panama. *Id.*

⁶⁷ Poddar, *supra* note 27, at 4.

overwhelming lack of support from the international community.⁶⁸ To the contrary, Swiss banks have launched a targeted counter-offensive, claiming the renewed global interest in curbing Swiss banking secrecy to be an attempt by foreign banks and government bureaucrats to capture assets currently held in Swiss banks in order to bolster their home countries' own depleted treasuries.⁶⁹

C. Offshore Banking, Bank Secrecy & Tax Evasion

1. Background

Offshore tax evasion has existed for centuries. Records as early as 1159 A.D. document the efforts of ship merchants and traders to avoid paying duties on merchandise by carefully relocating their activities from one port to another.⁷⁰ It was not until the advent of national-level income taxes in the 20th century, however, that modern-day "tax havens" (referred to in this Note as JATTs) were developed.⁷¹

In the 1920s, a small number of nations, including Bermuda, Switzerland, Liechtenstein and the Channel Islands, ratified tax laws deliberately designed to attract foreign capital by offering taxes at reduced rates.⁷² Additionally, other jurisdictions marketed themselves as havens of "banking privacy."⁷³ The utilization of JATTs soon became a popular and established method for wealthy individuals and businesses to shield income from taxes imposed by their home countries, resulting in a proliferation of tax havens across the world; by the 1950s, dozens nations could be qualified as JATTs.⁷⁴ The reason for such rapid growth can be attributed to two primary accelerants.⁷⁵ First, high marginal national-level income tax rates led citizens to seek alternative opportunities.⁷⁶ For example, the UK's top marginal tax rate exceeded eighty percent.⁷⁷ Second, improvements in telecommunications and the growth in international travel enabled

⁶⁸ See John Stonestreet, *UBS Tax Deal is Swiss Bank Secrecy's Waterloo*, REUTERS, Feb. 19, 2010, <http://www.reuters.com/article/idUSTRE5111ZP20090219>.

⁶⁹ Stephanie Baker & Warren Giles, *Geneva Sees Opportunity in Bern's Concessions on Bank Secrecy*, BLOOMBERG, July 1, 2009, <http://www.bloomberg.com/apps/news?pid=20601109&sid=apQp8dVyoPKg>.

⁷⁰ PLN Lawyers, http://www.pln.com.au/index.php?option=com_content&task=view&id=84 (last visited Oct. 30, 2009).

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *See id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

individuals and companies to identify and engage in alternative banking options with increasing ease and limited disruption.⁷⁸

By 1956, the list of JATTs included Liberia, Panama, Curacao, the Bahamas, Luxembourg, Uruguay, Argentina, Costa Rica, Ecuador, Aden, Lebanon, Gibraltar, Rhodesia and the Solomon Islands.⁷⁹ Each national JATT established its own tax scheme and rules for enforcing such scheme.⁸⁰

As JATTs increased in both numbers and importance, so too did the controversy surrounding them. JATTs were increasingly criticized for diluting tax bases and causing an unfair shift of the overall tax burden from wealthy tax evaders to loyal middle class taxpayers.⁸¹ In February 1961, one month into his new administration, President John F. Kennedy called for an end to the abuse of “foreign tax havens,” and asked Congress to enact legislation to force such JATTs “out of existence.”⁸²

In the late 1980s, the G-7 and the Organization for Economic Cooperation and Development (OECD)⁸³ threatened to dismantle the most flagrant JATTs through the imposition of targeted sanctions.⁸⁴ Additionally, the OECD began issuing reports and guidelines outlining harmful tax practices⁸⁵ and engaged in dialogue aimed at among other

⁷⁸ *Id.*

⁷⁹ Burton Crane, *Tax Havens Draw Many Companies*, N.Y. TIMES, Aug. 19, 1956, at 135.

⁸⁰ PLN Lawyers, *supra* note 70.

⁸¹ Crane, *supra* note 79.

⁸² Robert Metz, *Users of 'Tax Havens' Abroad Batten Down for Political Gale*, N.Y. TIMES, Feb. 26, 1961, at F1.

⁸³ The OECD is an intergovernmental economic organization in which the 30 member countries discuss, develop and analyze economic and social policy. The OECD is organized around three main bodies: the Council, the Committees, and the Secretariat. Committees are comprised of representatives of all the member countries. The overriding committee is the Council, which has decision-making power. It is composed of one representative for each member country, generally at the level of Ambassador, gives guidance to the OECD, and directs its work. JAMES JACKSON, CRS REPORT FOR CONGRESS 2 (2007), *available at* <http://www.fas.org/sgp/crs/misc/RS21128.pdf>.

⁸⁴ PLN Lawyers, *supra* note 70.

⁸⁵ *Id.* For the purposes of this Note, “harmful tax practices” are tax practices that are anti-competitive and undermine fair competition and public confidence in tax systems. Organization for Economic Co-Operation and Development, http://www.oecd.org/departement/0,3355,en_2649_33745_1_1_1_1_1,00.html (last visited, March 14, 2010).

things, eliminating preferential tax regimes within OECD member states.⁸⁶ The “Harmful Tax Practices” project launched in 1996 at the directive of the G-7 and the first report stemming therefrom, “Harmful Tax Competition: An Emerging Global Issue,”⁸⁷ was released in 1998.⁸⁸ Today, forty-eight years after President Kennedy’s declaration, President Barack Obama has embarked upon a comparable mission to mitigate the existence of JATTs, vowing to “detect and pursue” U.S. tax evaders who utilize “offshore tax shelters.”⁸⁹

2. *How Offshore Arrangements Facilitate Tax Evasion*

Limited transparency regarding financial activities in foreign jurisdictions may tempt individuals and corporations to conceal illegal activity from domestic regulators and enforcement officials through the use of offshore entities.⁹⁰ For example, individuals can exploit corporate entities to mask the ownership of assets or income through the use of limited liability corporations (LLCs), limited liability partnerships (LLPs), and IBCs, as well as trusts, foreign financial accounts, debit or credit cards, and other related instruments.⁹¹ According to the U.S. Internal Revenue Service (IRS), offshore schemes have become increasingly complex – sometimes containing multiple legal and structural layers as well as myriad transactions in an effort to obfuscate the true nature and ownership of the assets or income.⁹²

Additionally, establishing offshore entities is generally both simple and inexpensive.⁹³ For example, a Cayman Islands exempted company⁹⁴

⁸⁶ OECD, PROMOTING TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES 7 (2010), <http://www.oecd.org/dataoecd/32/45/43757434.pdf>. The OECD has declared the project a success. By 2004, all but one of the preferential tax regimes identified within the OECD had been abolished, amended or found not to be harmful. The only outstanding regime was the Luxembourg 1929 holding company regime. In December 2006, Luxembourg enacted legislation to abolish the regime by the end of 2010. *Id.*

⁸⁷ *Id.* Luxembourg and Switzerland abstained in the approval of the report. *Id.* at 7.

⁸⁸ *Id.*

⁸⁹ Associated Press, *Obama Cracks Down on Overseas Tax Loopholes*, MSN.BC.COM, May 4, 2009, www.msnbc.msn.com/id/30557517/.

⁹⁰ UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, REPORT TO THE CHAIRMAN AND RANKING MEMBER, COMMITTEE ON FINANCE, U.S. SENATE, 32 (2008), *available at* <http://www.gao.gov/new.items/d08778.pdf>.

⁹¹ U. S. GOV’T ACCT. OFFICE, TAX COMPLIANCE: OFFSHORE FINANCIAL ACTIVITY CREATES ENFORCEMENT ISSUES FOR IRS (2009), *available at* <http://www.gao.gov/htext/d09478t.html>.

⁹² U.S. GOV’T ACCT. OFFICE, *supra* note 90.

⁹³ U.S. GOV’T ACCT. OFFICE, *supra* note 91.

can be created for less than US\$600⁹⁵ and the company is neither required to maintain a register of shareholders in the Cayman Islands nor hold annual shareholders' meetings.⁹⁶ Other offshore jurisdictions provide comparable advantages to those seeking to establish offshore entities.⁹⁷

Furthermore, because taxpayers' compliance in offshore jurisdictions is largely dependent upon voluntary self-reporting, individuals might be tempted to underreport earnings realized in JATTs and thus, avoid paying the full amounts dictated by their domestic tax regimes.⁹⁸ According to an IRS study, in the absence of third party reporting of taxpayers' income to the IRS, such taxpayers tend to include less than half of the relevant reportable income on their tax returns.⁹⁹

Importantly, large international financial firms have suffered accusations of responsibility by U.S. governmental bodies for advising U.S. clients on the use of offshore structures to conceal assets and evade U.S. taxes.¹⁰⁰ In 2008, for example, the IRS announced that Liechtenstein Global Trust Group (LGT), a leading Liechtenstein-based financial institution, assisted U.S. citizens in evading taxes. In a separate case, Bradley Birkenfeld, a director in the private banking division of UBS, pled guilty in Federal district court in June 2008 to conspiring with an American billionaire real estate developer and Swiss bankers to help the developer avoid the payment of \$7.2 million in owed taxes by assisting in concealing \$200 million of assets in Switzerland and Liechtenstein.¹⁰¹ Birkenfeld admitted that from 2001 through 2006, while he was employed at UBS, he regularly traveled to the U.S. in an effort to assist wealthy Americans conceal their ownership of assets held offshore and avoid paying taxes on

⁹⁴ If the proposed activities of a company are to be executed primarily outside the Cayman Islands, the company may register as an exempted company. Amongst other characteristics, an exempted Cayman's company does not have to: (1) keep a register of members open for public inspection; (2) hold an annual general meeting; or (3) use "Limited" or the abbreviation "Ltd." after its name. Additionally, an exempted company may: (1) issue shares with nominal or no par value; and (2) express its capital in any currency. Investing in Cayman, <http://www.caymanchamber.ky/investing/business.htm>.

⁹⁵ This figure was calculated without considering likely service providers' fees. U.S. GOV'T ACCT. OFFICE, *supra* note 90, at 27.

⁹⁶ *Id.* This process is comparable to the regulatory process in the United States wherein notice is given of proposed rulemaking and the public is invited to comment on the proposed rules. *Id.* at 27 n.25.

⁹⁷ *See id.* at 26.

⁹⁸ U.S. GOV'T ACCT. OFFICE, *supra* note 91.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

the income generated from those assets.¹⁰² In February 2009, UBS entered into a deferred prosecution agreement with the U.S. Department of Justice (DOJ) for scheming to defraud the U.S. government by facilitating the concealment of assets of U.S. citizens through UBS accounts held in the names of "nominees and/or sham entities."¹⁰³ As a result of such proceedings, UBS agreed to pay \$780 million in fines, penalties, interest and restitution for its actions in connection with the case.¹⁰⁴

3. JATTs

a. *A brief debate: proponents vs. opponents*

Proponents of JATTs argue that their benefits outweigh their detriments. Many JATTs are former Western European colonies that would not have survived without the foreign capital their advantageous tax rates and banking practices are responsible for attracting.¹⁰⁵ Additionally, JATTs offer individuals in emerging market nations invaluable access to safe bank accounts in stable currencies while shielding deposits from currency controls that limit the quantities of funds individuals must transfer into or out of his home country.¹⁰⁶ Finally, to wealthy persons, anonymous accounts are considered an invaluable tool for legitimate purposes.¹⁰⁷

Critics, on the other hand, purport the systemic and internationally scaled damage caused by JATTs outweighs the remuneration and other benefits accruing to host regimes. Specifically, opponents argue the existence of JATTs directly inhibit non-JATT governments' abilities to obtain the requisite tax receipts necessary to build roads, fund schools, and otherwise sustain civic life.¹⁰⁸ The OECD reports that as of 2009, the value

¹⁰² *Id.*

¹⁰³ *Id.* A nominee is a party who holds bare legal title for the benefit of others or who receives and distributes funds for the benefit of others. BLACK'S LAW DICTIONARY (8th ed. 2004). A sham entity is an organization that is not what it seems. *Id.*

¹⁰⁴ U.S. GOV'T ACCT. OFFICE, *supra* note 91.

¹⁰⁵ Recknagel, *supra* note 22.

¹⁰⁶ *The Other Banking Drama*, *supra* note 42.

¹⁰⁷ *Id.* For example, banking in a country with bank secrecy laws can (1) provide a depositor shelter from a politically unstable home country; (2) enable companies to avoid high inflation rates in their home country; and (3) provide a haven for individuals facing oppression in their home country (such as the Jews in Nazi, Germany). See, e.g., Sidney Weintraub, *Disrupting the Financing of Terrorism*, WASH. Q., Winter 2002, at 56, available at

http://muse.jhu.edu/journals/washington_quarterly/v025/25.1weintraub.pdf.

¹⁰⁸ Recknagel, *supra* note 22. See also *OECD Estimates \$11 Trillion Parked in Tax Havens*, BUS. STANDARD, Apr. 4, 2009, <http://www.business-standard.com/india/news/oecd-estimates-11-trillion-parked-in-tax-havens/353935/>.

of assets held in JATTs ranges from \$1.7 trillion to \$11.5 trillion, which translates into billions of dollars in lost tax revenues.¹⁰⁹

b. Developments in the OECD tax haven list

Over the past decade numerous modifications have been made to transparency requirements and exchange of information practices between and among both national and international regulatory bodies in an effort to decrease the number of jurisdictions deemed by the OECD to be functioning as tax havens. In June 2000, over forty jurisdictions were identified by the OECD's Committee on Fiscal Affairs as qualifying as Uncooperative Tax Havens (UTHs).¹¹⁰ By 2007, however, a majority of such qualifying jurisdictions had committed to implement transparency and exchange of information reforms sufficient to result in their de-listing as tax havens.

By 2002, only three jurisdictions remained on the OECD's list of UTHs: Andorra, Monaco and Liechtenstein.¹¹¹ In March 2009, these remaining three UTHs declared their intent to implement international standards in a timely manner and, as such, were removed from the OECD's list in May 2009.¹¹² The OECD does not currently categorize any jurisdictions as UTHs.¹¹³

The key principles of transparency and exchange of information for tax purposes has been summarized by the OECD as: (1) exchange of information on request where it is "foreseeably relevant" to the administration and enforcement of the domestic laws of a treaty partner; (2) no restrictions on exchange caused by bank secrecy or domestic tax interest requirements; (3) availability of reliable information, particularly accounting, bank and ownership information and powers to obtain it; (4) respect for taxpayers' rights; and (5) strict confidentiality of information exchanged.¹¹⁴

¹⁰⁹ *Id.*

¹¹⁰ JEFFREY OWENS, COUNTERING OFFSHORE TAX EVASION 12 (2009) *available at* <http://www.oecd.org/dataoecd/23/13/42469606.pdf>.

¹¹¹ ORG. FOR ECON. CO-OPERATION AND DEV., LIST OF UNCO-OPERATIVE TAX HAVENS (2009), http://www.oecd.org/document/57/0,3343,en_2649_33745_30578809_1_1_1_1,00.html.

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ *Id.*

4. *The Broader Policy Implications of Offshore Evasion*

Tax evasion facilitated by OFCs imparts adverse effects extending beyond lost revenue for a home nation. Financial experts assert that offshore tax evasion also undermines the fairness and integrity of national tax systems and negatively affects the willingness of law-abiding taxpayers to voluntarily comply with statutorily defined tax obligations.¹¹⁵ Public attitudes towards tax compliance are influenced by perception and the “voluntary” element of compliance can be badly eroded if a minority of taxpayers, usually those with significant incomes, can avoid or are perceived to be evading their taxes.¹¹⁶ Furthermore, tax evasion techniques employed by certain individuals restricts the abilities of governments to decrease statutory tax rates for general populace. As Treasury Secretary Henry Paulson conveyed in testimony before the Senate Financing Committee, “when people fail to pay their taxes, it serves as a *de facto* tax increase on everyone else.”¹¹⁷

Since tax evaders’ decisions on where to domicile funds is often motivated by the ease by which evasion techniques can be implemented in a particular jurisdiction (as opposed to being motivated by marginal differences in the true economic return on capital due to advisory and/or execution expertise, for example), competition based on banking secrecy and deficient tax cooperation/coordination has the potential significantly to diminish the furtherance of global economic welfare.¹¹⁸ This unconstructive result stems at least partially from the reduction in gross returns on investment of JATT domiciled funds to reflect the fees and expenses associated with, among others, scheme promoters, arrangers, advisors, offshore trustees, and nominees.¹¹⁹

Excessive banking secrecy and a lack of multilateral tax cooperation is especially detrimental in developing countries where offshore tax evasion may further erode weak tax bases.¹²⁰ In such jurisdictions, even relatively small amounts (by international standards) of unreported assets can divert substantial proportions of critical governmental revenue. This lost revenue can have far-reaching results by jeopardizing such governments’ abilities to invest in the vital social services and infrastructure projects upon which long-term sustainable economic

¹¹⁵ *The Role of Exchange of Information: Hearing Before the S. Fin. Comm. on Offshore Tax Evasion*, 110th Cong. 5 (2007) (written testimony of Jeffrey Owens, Dir., OECD Center for Tax Policy and Administration), available at <http://www.ceff.univ-cezanne.fr/documents/owen.doc>.

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*

development depends.¹²¹ Ultimately, excessive banking secrecy and an unwillingness of countries to cooperate to counter tax havens undermine the national fiscal sovereignty of these countries.¹²² In a global economy, individual governments are capable of maintaining sovereignty over the design of their respective tax systems only insofar as they can rely on the international community to share information needed to enforce their tax policy decisions – decisions that reflect their respective economic, social and political needs and preferences.¹²³

IV. GLOBAL RESPONSE: INITIATIVES TO COMBAT OFFSHORE TAX ABUSE

Concerns about abuses of OFCs and the role of JATTs in facilitating tax evasion are longstanding. Over the past decade, the U.S. and the international community have undertaken several initiatives to oppose such abuses and in recent years, this effort has intensified.¹²⁴ For example, at the London Summit in April 2009, the G-20 Communiqué issued a report expressing the organization's intention to take actions against (including potentially imposing sanctions on) non-cooperative jurisdictions, including several JATTs, in an effort to strengthen global financial supervision and regulation.¹²⁵ While the global community's ability to produce a panacean solution to international tax evasion appears unlikely, a modular approach involving discrete, but complimentary elements has been initiated to eliminate opportunities for tax avoidance on a piecemeal basis. A brief summary of select initiatives follows.

A. International Provisions for Tax Information Exchange

Exchange of information between sovereign tax authorities can be accomplished either bilaterally or multilaterally. When coordination between tax jurisdictions is pursued on a bilateral basis, two primary types

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Id.*

¹²⁴ STAFF OF S. COMM. ON THE PERMANENT SUBCOMM. ON INVESTIGATIONS, *supra* note 5, at 18. For example, in 2006, the Australian Government pledged to spend \$300 million over seven years to fund a taskforce to investigate internationally promoted tax arrangements that allegedly involve tax avoidance or evasion. Australian Taxation Office, <http://www.ato.gov.au/corporate/content.asp?doc=/content/00169431.htm> (last visited Mar. 8, 2010).

¹²⁵ G20, THE GLOBAL PLAN FOR RECOVERY AND REFORM 4 (2009), <http://www.g20.org/Documents/final-communique.pdf>.

of agreements are utilized: Double Taxation Treaties (DTTs) and Tax Information Exchange Agreements (TIEAs).¹²⁶

1. *Double Taxation Treaties*¹²⁷

DTTs are comprehensive agreements between two sovereign tax jurisdictions to prevent income and/or profits derived from international economic activity from being subject to two separate tax regimes. A primary reason for countries to enter into DTTs is to foster cross-border investment and economic activity by enhancing after tax returns to corporations and investors who would otherwise find their assets and/or profits significantly decreased due to taxation under multiple tax regimes. There are over 2,000 such bilateral treaties currently in existence.¹²⁸

The U.S. is currently party to fifty-seven DTTs, under which foreign states have agreed to mechanisms and standards defining the means by which evidence relevant to tax law enforcement can be exchanged.¹²⁹ DTTs generally include the reciprocal agreement of the treaty parties to exchange evidence relating to tax law enforcement in special situations.¹³⁰ Almost all U.S. DTTs limit information sharing to instances in which the requesting state makes a specific, targeted request.

As of May 1951, Switzerland is one of the many nations with whom the U.S. has executed a DTT.¹³¹ In 1996, the U.S. and Switzerland entered into a new DTT, which was later ratified in 1997. Like the 1951 treaty and like other DTTs the United States has executed, the 1996 DTT requires a particularized showing of relevance in order information to be exchanged in compliance with both U.S. and Swiss law. Under a 2003 “Mutual Agreement” concerning the 1996 Treaty, each party must

¹²⁶ Tax Justice Network, *Tax Information Exchange Arrangements* (Draft TJN Briefing Paper, 2009), http://www.taxjustice.net/cms/upload/pdf/TJN_0903_Exchange_of_Info_Briefing_draft.pdf.

¹²⁷ DTTs are also referred to as Double Taxation Agreements (or DTAs) in this Note.

¹²⁸ Tax Justice Network, *supra* note 126.

¹²⁹ IRS Publication 515 (rev. Mar. 2010), p. 54-55, *available at* <http://www.irs.gov/pub/irs-pdf/p515.pdf> (listing DTAs to which the United States is a party as of December 31, 2008).

¹³⁰ Brief of UBS AG, *United States v. UBS AG*, No. 109CV20423, 2009 WL 1612393, at *9 (S.D. Fla. Apr. 30, 2009).

¹³¹ *Id.*

demonstrate a “reasonable suspicion” of “tax fraud or the like” to secure assistance under the treaty.¹³²

The most current version of the OECD Model DTA (Model DTA) was developed in 2005.¹³³ It provides for the exchange of information which is “foreseeably relevant” for the “administration or enforcement of ... taxes of every kind” and requires both parties to use its powers to obtain and provide such information even if it is not needed for its own tax purposes (Art. 26 (4)).¹³⁴ Additionally, the 2005 version overrides banking secrecy by mandating that bank secrecy cannot serve as a reason for categorical refusal to exchange information (Art. 26 (5)).¹³⁵ Earlier versions of the Model DTA were much weaker in that they were limited to the exchange of information necessary for the purposes of the treaty, which many states interpreted as meaning only to prevent double taxation, but not to prevent tax evasion and avoidance.¹³⁶

2. Tax Information Exchange Agreements

The second type of treaty is the TIEA. TIEAs are intended for use with offshore jurisdictions that either do not want to, or are not eligible to, enter into fully-fledged DTTs with their major trading partners.¹³⁷ While TIEAs are narrower in scope than DTTs, they are more comprehensive than DTTs on the subject of information exchange.¹³⁸

A TIEA often provides for exchange of information regarding the beneficial ownership of companies or trusts based upon a formal request received by the competent authority in the signatory nations.¹³⁹ Typically, a request must be made on an individual case basis and the subject of the request must be under investigation in the requesting jurisdiction.¹⁴⁰ The requesting country must also have pursued “all means available” within its own jurisdiction and strict confidentiality provisions ensure that

¹³² *Id.*, quoting Mutual Agreement Regarding the Administration of Article 26 of the Swiss-U.S. Income Tax Convention of October 2, 1996, U.S.-Switz., ¶ 5, Jan. 23, 2003.

¹³³ Tax Justice Network, *supra* note 126, at 2.

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ *Id.* It is important to note that many existing DTAs still use the older version of article 26. *Id.*

¹³⁷ The Lowtax Network, http://www.usa-international-offshore-company-tax.com/tax_info_exchange.asp (last visited Mar. 8, 2010).

¹³⁸ Tax Justice Network, *supra* note 126, at 2.

¹³⁹ The Lowtax Network, *supra* note 137.

¹⁴⁰ *Id.*

information is not leaked to third parties.¹⁴¹ The TIEA is not a binding instrument; rather, it provides two draft models for bilateral agreements.¹⁴² To-date, numerous bilateral agreements have been based on this Agreement.¹⁴³

Modern TIEAs are based on an OECD Model Agreement released in April 2002 by the Global Forum on Taxation, which consisted of representatives from OECD Member countries as well as delegates from Aruba, Bermuda, Bahrain, Cayman Islands, Cyprus, Isle of Man, Malta, Mauritius, the Netherlands Antilles, the Seychelles and San Marino.¹⁴⁴

B. *Qualified Intermediary Program (QI Program)*

In 2000, the IRS established the QI program, which encourages foreign investment in U.S. institutions by simplifying reporting requirements for foreign banks investing and/or depositing funds therein.¹⁴⁵ In accordance with the program, the IRS enters into agreements with foreign financial institutions (mostly banks) that commit to serve as “qualified intermediaries” by collecting, processing, and documenting U.S. source income information from its customers.¹⁴⁶ Amongst other requirements, the QI must identify American investors receiving U.S. source income through the QI, which benefits the IRS in its quest to increase transparency.¹⁴⁷

¹⁴¹ *Id.*

¹⁴² Tax Information Exchange Agreements, Organization for Economic Co-Operation and Development, http://www.oecd.org/document/7/0,3343,en_2649_33767_38312839_1_1_1_37427_00.html (last visited Mar. 8, 2010).

¹⁴³ *Id.*

¹⁴⁴ Tax Information Exchange Agreements, Organization for Economic Co-Operation and Development, http://www.oecd.org/document/7/0,3343,en_2649_33767_38312839_1_1_1_1,00.html (last visited Feb. 1, 2010).

¹⁴⁵ *Tax Haven Banks and U. S. Tax Compliance - Obtaining the Names of U.S. Clients with Swiss Accounts: Hearing Before the S. Comm. on Homeland Security and Governmental Affairs Permanent Subcomm. on Investigations*, 111th Cong. 3 (2009) (prepared testimony of Doug Shulman Commissioner IRS), available at http://hsgac.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=40341c8c-e8af-4160-a90a-c580585d2fe0 [hereinafter Shulman Testimony].

¹⁴⁶ Tax Policy Center, http://www.taxpolicycenter.org/taxtopics/2011Budget_offshore.cfm (last visited Feb. 10, 2010). The primary document is a “withholding certificate,” by which customers certify whether they are U.S. citizens or residents and, if neither, whether they qualify for reduced U.S. withholding tax. *Id.*

¹⁴⁷ *Id.*

In exchange for entering into a QI agreement, foreign financial institutions are granted the authority to determine the appropriate amounts of U.S. withholding taxes, thereby eliminating the need for clients to file for refunds of excess withholding taxes.¹⁴⁸ By allowing foreign banks to report funds subject to withholding on an aggregate basis for all foreign customers invested in U.S. securities, the onerous requirements placed upon foreign institutions managing U.S. investments on behalf of clients is greatly reduced.¹⁴⁹ The QI program has been successful and well utilized by larger foreign institutions, and most major international financial institutions have already enrolled as QI participants.¹⁵⁰

The IRS cites the QI program as critical to the comprehensive administration of taxes in a global economy.¹⁵¹ Specifically, by bringing foreign financial institutions more directly into the U.S. tax information reporting system, the IRS hopes to better ensure that U.S. citizens with investments managed by foreign institutions fulfill their obligations under the U.S. tax code and that foreign persons are subject to the proper withholding taxes.¹⁵² Effective January 1, 2001, UBS entered into a QI agreement with the IRS.¹⁵³

As of the publication of this Note, elements of the QI program remain in flux and the IRS and Treasury Department are currently considering modifications to the program, which will include, among other

¹⁴⁸ *Id.*

For example, dividends paid by U.S. companies to foreign investors are subject to a withholding tax at a statutory rate of 30 percent, but if the investor resides in a country with a tax treaty with the United States, the tax is reduced to 15 percent. To get the 15 percent rate, the investor must either establish treaty residence in advance or file for a refund from the IRS after the fact. By making a U.S. investment through a QI, a foreign investor can, for example, establish entitlement to withholding at treaty rates without revealing information about himself or herself to U.S. tax authorities or any other person within the United States.

Id.

¹⁴⁹ See Shulman Testimony, *supra* note 145, at 3.

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ Brief for Respondent in Opposition to the Petition to Enforce the John Doe Summons at 10, *United States v. UBS AG*, No. 1:09-CV-20423-Gold/McAliley (S.D. Fla. July 7, 2007), *available at* <http://www.ubs.com/1/ShowMedia/index/crossborder/home?contentId=166528&name=UBSBrief.pdf>.

things, expanding the information reporting requirements for U.S. customers holding foreign domiciled accounts and improving mechanisms for evaluating the risks of circumvention of U.S. tax obligations by U.S. citizens with such foreign domiciled accounts.¹⁵⁴

C. *European Union Savings Tax Directive (EUSTD or Directive)*

The EUSTD was adopted in June 2003 and went into effect on July 1, 2005, as one element of a tax reform package initiated by the European Commission in 1997.¹⁵⁵ The Directive applies to interest paid to individuals resident in an EU Member State other than the one where the interest is paid.¹⁵⁶ Member States had to transpose its provisions into national legislation.¹⁵⁷

As originally drafted, the EU STD aimed to implement a uniform “information exchange” regime to apply across the Union, with all countries agreeing to report interest on savings paid to the citizens of other Member States to those States' tax authorities.¹⁵⁸ In response to resistance from EU Member States with strong traditions of banking secrecy however, the Commission permitted a number of jurisdictions, including Austria, Luxembourg, Belgium and Switzerland, to apply a withholding tax. In November 2008, the EU Commission adopted an amended proposal to the STD in an effort to close existing loopholes and better prevent tax evasion. Among other things, the proposal extended the scope of the Directive to include income equivalent to interest obtained through investments in some innovative financial products and certain life insurance products.¹⁵⁹

D. *U.S. Legislation & Initiatives*

1. *Bank Secrecy Act of 1970 (BSA)*

The BSA¹⁶⁰ is the first piece of enacted U.S. legislation to directly fight money laundering¹⁶¹ and today, serves as the primary directive in the

¹⁵⁴ Shulman Testimony, *supra* note 145, at 3.

¹⁵⁵ See The Low Tax Library, <http://www.lowtax.net/specials/std.html#exec> (last visited Feb. 1, 2010).

¹⁵⁶ *Id.*

¹⁵⁷ European Commission's Taxation and Customs Union Directorate-General, http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/index_en.htm (last visited Feb. 1, 2010).

¹⁵⁸ The Low Tax Library, *supra* note 155.

¹⁵⁹ European Commission's Taxation and Customs Union Directorate-General, http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/index_en.htm (last visited Feb. 1, 2010).

¹⁶⁰ Bank Secrecy Act, Pub. L. No. 91-508, 84 Stat. 1114 (1970) (codified as amendments in scattered sections of 12 U.S.C. §§ 1829b, 1951-59, 5311-22

U.S.'s efforts to detect and deter criminal financial activities.¹⁶² Designed to prevent financial institutions from being used as intermediaries for, or to hide the transfer or deposit of money derived from, criminal activity,¹⁶³ the BSA empowers the U.S. government to require that financial institutions provide comprehensive reports of certain financial transactions. Specifically, the BSA authorizes the U.S. Secretary of the Treasury to promulgate regulations for the retention of records and the creation of reports that have "a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings."¹⁶⁴ It also authorizes the U.S. Treasury Department to require financial institutions to report any "suspicious transaction relevant to a possible violation of law or regulation."¹⁶⁵

The U.S. Congress (Congress) passed the BSA in response to the "unavailability of foreign and domestic bank records of customers thought to be engaged in illegal activities."¹⁶⁶ In the late 1960s, Congress learned that the proceeds of criminal activities conducted in the U.S. and large amounts of unreported income were being deposited in foreign bank accounts, predominantly in nations with strict bank secrecy laws.¹⁶⁷ The foreign bank secrecy laws hindered the efforts of U.S. investigators in two ways: (1) the laws made it challenging for investigators to obtain financial information from foreign financial institutions relating to the criminal activity; and (2) even when U.S. investigators were successful in gaining access to secret financial data, the privacy procedures mandated by foreign laws frequently delayed the responses to their inquiries.¹⁶⁸

(2009)). The BSA is also commonly referred to as (1) the "Currency and Foreign Transactions Reporting Act," (2) an "anti-money laundering" law (AML), or (3) "BSA/AML." Financial Crimes Enforcement Network, Department of the Treasury, http://www.fincen.gov/statutes_regs/bsa/ (last visited Mar. 14, 2010).

¹⁶¹ IRS.gov, <http://www.irs.gov/businesses/small/article/0,,id=152532,00.html>.

¹⁶² Government Accountability Office, <http://www.gao.gov/products/GAO-07-212> (last visited Mar. 14, 2010).

¹⁶³ LILIAN B. KLEIN, BANK SECRECY ACT: BACKGROUND, STATUTE AND INTERPRETATION 1 (2007).

¹⁶⁴ Cal. Bankers Ass'n v. Shultz, 416 U.S. 21, 82 (1974).

¹⁶⁵ FIN. CRIMES ENFORCEMENT NETWORK, DEP'T OF THE TREASURY, GUIDANCE TO FINANCIAL INSTITUTIONS ON FILING SUSPICIOUS ACTIVITY REPORTS REGARDING LOAN MODIFICATION/FORECLOSURE RESCUE SCAMS 2 (2009), *available at* http://www.fincen.gov/statutes_regs/guidance/pdf/fin-2009-a001.pdf. These reports, called Suspicious Activity Reports (SARs), are filed with the Treasury Department's Financial Crimes Enforcement Network (FinCEN). *Id.*

¹⁶⁶ California Bankers Ass'n, 416 U.S. at 21.

¹⁶⁷ L. RICHARD FISCHER, THE LAW OF FINANCIAL PRIVACY ¶ 4.01 (1998).

¹⁶⁸ *Id.*

At the same time, U.S. financial institutions started to decrease their in-house recordkeeping procedures.¹⁶⁹ Historically, U.S. financial institutions routinely copied and recorded all checks that circulated through the business and the details of any other substantial financial transactions.¹⁷⁰ The federal government would then utilize these records to investigate and prosecute suspected tax evasion and organized crime offenders.¹⁷¹ Thus, as financial institutions reduced their routine bookkeeping activity, it became more difficult for federal investigators to perform their law enforcement duties.¹⁷² To address these impediments, Congress passed the BSA.¹⁷³

Since being implemented in 1970, the BSA has evolved through amendments and the passage of additional legislation to improve the efficacy of the laws and reporting requirements it promulgates.¹⁷⁴ The most recent comprehensive changes were made through the United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act ("U.S. PATRIOT Act") of 2001.¹⁷⁵ Ultimately, the BSA strives to ensure through its requirements that, among other things, financial institutions are able to reconstruct questionable transactions.¹⁷⁶

2. Offshore Voluntary Compliance Initiatives

In January 2003, the IRS launched an Offshore Voluntary Compliance Initiative (2003 OVCI) aimed at bringing taxpayers who used "offshore" payment cards or other offshore financial arrangements to hide their income back into compliance with U.S. tax law.¹⁷⁷ Under the 2003 OVCI, eligible taxpayers who turned themselves in would not face civil fraud and information return penalties.¹⁷⁸ However, taxpayers did still have

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ For a timeline of events, see Financial Crimes Enforcement Network, Department of the Treasury, *BSA Timeline*, http://www.fincen.gov/statutes_regs/bsa/bsa_timeline.html (last visited Mar. 14, 2010).

¹⁷⁵ KLIEN, *supra* note 163, at 74. See also The United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (2001).

¹⁷⁶ KLIEN, *supra* note 163, at 6.

¹⁷⁷ Press Release, IRS, IRS Unveils Offshore Voluntary Compliance Initiative; Chance for 'Credit-Card Abusers' to Clear Up Their Tax Liabilities (Jan. 14, 2003), <http://www.irs.gov/newsroom/article/0,,id=105689,00.html>.

¹⁷⁸ *Id.*

to pay back taxes, interest and certain accuracy or delinquency penalties.¹⁷⁹ Eligible taxpayers who came forward also avoided criminal prosecution based upon application of the revised voluntary disclosure practice.¹⁸⁰

In 2009, the IRS established a similar, but revised, offshore voluntary disclosure program (2009 OVDP) to provide taxpayers with a way into the reporting system while avoiding significant penalties.¹⁸¹ The stated objective of the 2009 OVDP was to bring taxpayers that have used undisclosed foreign accounts and undisclosed foreign entities to avoid or evade tax into compliance with United States tax laws.¹⁸² Additionally, the information gathered from taxpayers making voluntary disclosures was used to progress the IRS's understanding of how foreign accounts and foreign entities are promoted to U.S. taxpayers as ways to avoid or evade tax.¹⁸³

In response to the 2009 program, which ended in mid-October 2009, 14,700 Americans made voluntary disclosures of secret offshore bank accounts to the IRS.¹⁸⁴ About 12,000 came after the August agreement between the U.S. and Switzerland (discussed below in Section V(D)(2)).¹⁸⁵

3. Obama Proposal

On May 4, 2009, President Obama announced a set of proposals to “crack down on illegal overseas tax evasion, close loopholes, and make it more profitable for companies to create jobs here in the United States.”¹⁸⁶ Specifically, the proposals are intended to ensure that the U.S. tax code does not “stack the deck against job creation” in the U.S. and that, it

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ RSM McGladrey Tax Digest, <http://www.rsmmcgladrey.com/Tax-Digest-September-2009/Tax-Digest-September-2009-International?itemid=844&mid=844> (last visited, Feb. 1, 2010).

¹⁸² IRS.GOV, FREQUENTLY ASKED QUESTIONS 2 (2009), http://www.irs.gov/pub/irs-utl/faqs-revised_6_24_checked_v2.pdf.

¹⁸³ *Id.*

¹⁸⁴ Joseph Heaven, David Voreacos & Klaus Wille, *UBS Client Wins Case on Transfer of Tax Data to U.S. (Update4)*, BUS. WK., Jan. 22, 2010, <http://www.businessweek.com/news/2010-01-22/ubs-client-wins-case-on-transfer-of-tax-data-to-u-s-update3-.html>.

¹⁸⁵ *Id.*

¹⁸⁶ Press Release, Grand Foyer, Remarks by the President on International Tax Policy Reform (May 4, 2009), http://www.whitehouse.gov/the_press_office/Remarks-By-The-President-On-International-Tax-Policy-Reform.

reduces “the amount of taxes lost to tax havens.”¹⁸⁷ Within these two broad areas, the Obama administration proposed: (1) replacing tax advantages for creating jobs overseas with incentives to create them at home; and (2) cracking down on overseas tax havens.¹⁸⁸ With regard to the former, the Administration suggested reforming deferral rules to curb a tax advantage for investing and reinvesting overseas and closing foreign tax credit loopholes and using savings to make permanent the tax credit for investing in research and experimentation at home.¹⁸⁹ In addressing the latter, the Administration recommended eliminating loopholes for “disappearing” offshore subsidiaries, cracking down on the abuse of tax havens by individuals and devoting new resources for IRS enforcement to help close the international tax gap.¹⁹⁰

V. CASE STUDY: UBS

Switzerland’s neutrality and national sovereignty, long recognized by foreign nations, has created a stable environment in which the Swiss banking sector has been able to develop and thrive.¹⁹¹ Recently, though, UBS – Switzerland’s largest bank – has become the focus of an international tax scandal which could result in detrimental repercussions for Swiss banking secrecy and the future of the Swiss banking system.¹⁹² At the heart of the controversy are the definitions of “tax evasion” and “tax fraud.” Under Swiss Law, bank data can be transferred to foreign tax authorities only in clear cases of tax fraud, not tax evasion.¹⁹³ This is because the latter is not a criminal offense in Switzerland.¹⁹⁴ Conversely, U.S. law does not draw a distinction between the two terms and thus, both may constitute a criminal offense.

This section examines (a) UBS’ bank profile; (b) the relevant provisions of Swiss and U.S. domestic law; (c) the history and content of the intergovernmental information exchange provisions of the Swiss-U.S. income tax treaty; (d) the announcement by the Government of Switzerland of a change in policy regarding information exchange on tax evasion and

¹⁸⁷ Press Release, Office of the Press Secretary, The White House, Leveling the Playing Field: Curbing Tax Havens and Removing Tax Incentives For Shifting Jobs Overseas (May 4, 2009), http://www.whitehouse.gov/the_press_office/leveling-the-playing-field-curbing-tax-havens-and-removing-tax-incentives-for-shifting-jobs-overseas/.

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ Bloomberg Businessweek, <http://bx.businessweek.com/swiss-banking/> (last visited Feb. 1, 2009).

¹⁹² *Id.*

¹⁹³ *UBS Tax Deal is Swiss Bank Secrecy's Waterloo*, *supra* note 68.

¹⁹⁴ *Id.*

the related initiation of negotiations to amend the Swiss-U.S. treaty; (e) the settlement between UBS and the U.S. and Swiss governments in August 2009 in an effort to create a pact that would abolish Swiss banking secrecy; (f) and the current status of intergovernmental information exchanges relating to the UBS matter.

A. UBS Bank Profile

Headquartered in Zurich and Basel, Switzerland, UBS provides services in wealth management, investment banking, and asset management to private, corporate and institutional clients around the world.¹⁹⁵ One of Switzerland's two "big" banks, UBS and the Credit Suisse Group together account for over fifty percent of the total balance sheet of all banks in the country.¹⁹⁶

Present in all major financial centers worldwide, UBS has offices in over fifty countries and employs more than 65,000 people around the world. Organizationally, thirty-six percent of UBS' employees work in the Americas, thirty-six percent in Switzerland, fifteen percent in the rest of Europe and thirteen percent in Asia Pacific.¹⁹⁷ Shares of UBS are traded on the SIX Swiss Exchange, the New York Stock Exchange (NYSE), and the Tokyo Stock Exchange (TSE).¹⁹⁸

UBS' self-proclaimed strategy is to concentrate on its three global core businesses – wealth management, asset management and investment banking – and retail and corporate banking services in Switzerland.¹⁹⁹ The company is a leading global wealth manager: it is a market leader (by client assets) in both Europe and Asia Pacific, in sixth position in the U.S. and one of the only firms of global scale focusing on wealth management as a core business.²⁰⁰ In 2008, UBS was among the top five firms globally in mergers and acquisitions based on deal volume.²⁰¹

UBS is one of the leading active asset managers globally and one of the largest mutual fund managers in Europe based on assets under management. Additionally, UBS is the leading firm for retail and commercial banking in Switzerland. It serves approximately 2.5 million individual clients and 133,500 corporations, institutional investors, public

¹⁹⁵ UBS, <http://www.ubs.com/1/e/about/ourprofile.html> (last visited Feb. 1, 2010).

¹⁹⁶ Swiss Bankers Association, <http://www.swissbanking.org/en/home/fs-allgemein.htm> (last visited Feb. 1, 2010).

¹⁹⁷ UBS, *supra* note 195.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Id.*

entities and foundations, collectively.²⁰² The bank limits its retail and commercial banking business to the Swiss market, concentrating on domestic opportunities and growing selected market segments.²⁰³

B. *Legal Clash: U.S. v. Swiss Law*

1. *Tax Evasion and Fraud*

The fundamental principal at the core of the U.S.-Swiss debate is the distinction between tax evasion and tax fraud. Under Swiss law, fraud presupposes criminal intent, whereas evasion can result from oversight. Accordingly, tax fraud occurs when a taxpayer deliberately uses forged or falsified documents in an effort to deceive the tax authorities and obtain undue tax advantages.²⁰⁴ The Swiss defend this view, arguing that modern tax law has become so complex and places such a high burden on the untrained citizen that it is easy to misreport on tax returns and, ultimately, one should not be penalized for lack of competency in tax reporting.²⁰⁵

On March 13, 2009, the Swiss Federal Council announced that in addition to extending international administrative assistance based on its double taxation agreements and bilateral treaties with the European Union, administrative assistance would be offered on individual cases of well-founded tax evasion. This addition brought Switzerland into line with international standards.²⁰⁶

2. *U.S. Domestic Law*

a. *Reporting obligations*

U.S. federal tax returns require taxpayers to report interest and ordinary dividends and capital gains. Specifically, Form 1040, Schedule B, Part III (Foreign Accounts and Trusts), requires taxpayers to (1) disclose any interest, or signatory, or other authority in a foreign financial account; and (2) state the country where the account is held.²⁰⁷ Taxpayers that have

²⁰² UBS,

http://www.ubs.com/1/e/investors/annual_reporting2008/spr2008/0001.html (last visited Feb. 1, 2010).

²⁰³ *Id.*

²⁰⁴ Swiss Bankers Association, *supra* note 44.

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ See IRS Form 1040, Schedule B – Interest and Ordinary Dividends (OMB No. 1545-0074), available at <http://www.wbsonline.com/download.aspx?fileID=09-form1040-scheduleb.pdf>.

such an interest or authority over a foreign account may also be required to file a Foreign Bank Account Report (FBAR or Form TDF 90-22.1).²⁰⁸

The FBAR must be filed by all U.S. persons who have an interest, signatory, or other authority over foreign accounts that have a combined value of more than \$10,000 at any time during the course of the year.²⁰⁹ The FBAR requires filers to report their name, address, and taxpayer identification number and disclose the type, location and account number of the foreign bank accounts and the maximum amount held in the accounts.²¹⁰

b. The criminal and civil risks of not disclosing an offshore account

Under U.S. law, a taxpayer who does not timely report income held offshore and neglects to participate in a voluntary disclosure risks prosecution for tax evasion, filing a false return, the failure to file a tax return and an FBAR, as well as conspiracy.²¹¹

The U.S. crime of tax evasion requires (1) a deficiency in tax; (2) an affirmative or attempted act of evasion; and (3) willfulness. The violation carries with it an imprisonment term of up to five years and a fine up to \$250,000.²¹² Taxpayers with undeclared offshore accounts may also be prosecuted for filing a false return.²¹³

3. *Swiss Law*

a. Swiss tax system

To understand the role and limits of Swiss banking secrecy with regard to tax offenses, it is important to first understand the Swiss approach to combating tax evasion.²¹⁴ The Swiss tax system is based on the principles of “self-declaration” and “good-faith” by the taxpayer.²¹⁵

²⁰⁸ IRS.gov, <http://www.irs.gov/businesses/small/article/0,,id=210244,00.html#FR2> (last visited Feb. 1, 2010).

²⁰⁹ 31 C.F.R. §§ 103.24, 103.27(c) (2006); 31 U.S.C.A. § 5314 (West 2010).

²¹⁰ *Id.*

²¹¹ Fran Obeid, 2009: *The Year of Enforcement Action against Offshore Bank Accounts*, LEXISNEXIS EMERGING ISSUES ANALYSIS (2009), <http://www.fo-ml.com/docs/ObeidpubLEXNEXArticle10609.pdf>.

²¹² 26 U.S.C.A. § 7201 (West 2010).

²¹³ Terry Philip Segal & Michael Mustokoff, *Advice for Tax Payers With Undeclared UBS Swiss Bank Accounts*, LAW. WKLY., Dec. 15, 2008, available at http://www.duanemorris.com/articles/static/segalmustokoff_mlw_121508.pdf

²¹⁴ SWITZERLAND & ITS FINANCIAL CENTRE, SWISSBANKING.ORG (2007), http://www.swissbanking.org/en/schweiz_finanzplatz.pdf.

²¹⁵ *See id.*

Information and documents that a client requests from a bank for the tax authorities may only be passed from the bank to the client, not directly from the bank to tax authorities, and not even the Swiss tax authorities have a right to obtain client information directly from a Swiss bank outside of a criminal prosecution.²¹⁶

The only automatic reporting obligation Swiss banks have is the legal obligation to report well-founded suspicions of money laundering to the authorities.²¹⁷ Additionally, while it is not the responsibility of the bank to oversee their clients' tax affairs, the bank cannot assist in tax evasion by issuing misleading to incomplete attestations.²¹⁸

From a technical perspective and with regard to the complexity of the rules, the Swiss tax system is similar to that of large countries. It is comprehensive - taxing, among other things, income, wealth, legal transactions, consumption, possessions, and expenditures.²¹⁹ Accordingly, Switzerland is not a tax haven in the traditional sense, as tax havens are typically states or territories, which impose no taxes or only limited, low taxes on income and assets.²²⁰

The Swiss taxation system is designed to follow the principles of a modern tax system including: (1) covering the needs of local, cantonal and federal governments; (2) distributing the tax burden according to economic capability; (3) enforcing tax law; and (4) being flexible enough to permit adjustments in accordance with the current economic climate.²²¹ These principles are preserved in the Swiss Federal Constitution.²²²

4. *The Tax Treaty*

Since 1996, a tax treaty between the U.S. and Switzerland has provided for the exchange of information between the two countries for

²¹⁶ *Id.*

²¹⁷ *Id.*

²¹⁸ Swiss Bankers Association, *supra* note 44.

²¹⁹ The Swiss Tax System, <http://www.ch.ch/private/00093/00098/00453/00454/index.html?lang=en> (last visited Feb. 1, 2010).

²²⁰ See TAX JUSTICE NETWORK, IDENTIFYING TAX HAVENS AND OFFSHORE FINANCE CENTRES 1 (2007),

www.taxjustice.net/cms/upload/pdf/Identifying_Tax_Havens_Jul_07.pdf.

²²¹ SWISS CONFEDERATION FEDERAL DEPARTMENT OF FINANCE FDF, BANKING SECRECY AND INTERNATIONAL TAX ISSUES (June 2009), <http://www.efd.admin.ch/themen/00796/01377/index.html?lang=en&download=M3wBUQCu/8ulmKDu36WenojQ1NTTjaXZnqWfVp3Uhmfnapmmmc7Zi6rZnqCkkIN5gHaCbKbXrZ2lhtTN34al3p6YrY7P1oah162apo3X1cjYh2+hoJVn6w==> (last visited Feb. 1, 2010).

²²² *Id.*

the prevention of tax fraud.²²³ The treaty did not extend, however, to tax evasion, which, in Switzerland, is considered an administrative matter and may be punished by no more than a fine.²²⁴

In mid-1996, as part of negotiations to update their 1951 income tax treaty, the U.S. and Switzerland modified the provisions on exchange of information. That new language was incorporated into the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (Tax Treaty), signed on October 2, 1996.²²⁵

The rules and procedures set out in Article 26 of the Tax Treaty provide the legal basis for Switzerland to exchange information concerning tax issues with the United States. Article 26 states in relevant part:

The competent authorities to the Contracting States shall exchange information (being information available under the respective taxation laws of the Contracting States) as is necessary for carrying out the provisions of the present Convention for the prevention of tax fraud or the like in relation to the taxes which are subject of the present Convention. In cases of tax fraud,

- (a) the exchange of information is not restricted by Article I (Personal Scope) and
- (b) if specifically requested by the competent authority of the Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of authenticated copies of unedited original records or documents.

Additionally, the Tax Treaty generally followed the OECD Model Tax Convention on Income and Capital (OECD Model Convention), which fails to authorize “fishing expeditions.”²²⁶ Specifically, Article 26 of the

²²³ Obeid, *supra* note 211, at n.19.

²²⁴ *Id.*

²²⁵ United States v. UBS AG, No. 109CV20423, 2009 WL 1612393, at *9 (S.D. Fla. 2009). The basic rules for interpreting treaties are set out in the Vienna Convention on the Law of Treaties of May 23, 1969 (Vienna Convention). Vienna Convention Article 26 states that a treaty is “binding upon the parties to it and must be performed by them in good faith.” Vienna Convention on the Law of Treaties, May 23, 1960, 1155 U.N.T.S. 331 (entered into force Jan. 27, 1980).

²²⁶ OECD, AGREEMENT ON EXCHANGE OF INFORMATION ON TAX MATTERS 14 (2005), <http://www.oecd.org/dataoecd/15/43/2082215.pdf>.

OECD Model Convention requires a degree of relevancy or specificity for the exchange of information. Article 26 (Exchange of Information) states:

The competent authorities of the Contracting States shall exchange such information as is *foreseeably relevant* for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention.²²⁷

Simultaneously, the U.S. and Switzerland executed a Memorandum of Understanding (MOU) and a Protocol, which elaborated the meaning of the term “tax fraud or the like” for purposes of the exchange of information provisions.²²⁸

On September 23, 2009, the U.S. and Switzerland modified the income tax treaty between the two countries.²²⁹ The amended protocol provides for the “exchange of information in tax matters to the widest possible extent without allowing the Contracting States to engage in ‘fishing expeditions’ or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer.”²³⁰ Additionally, the revised protocol mandates that the State seeking the information submit a request containing: (1) information identifying the person under investigation; (2) the time period for which the information is requested; (3) a description of the information sought and the tax purpose for seeking the information; and (4) information identifying the person thought to be in possession of the requested information.²³¹ If the U.S. and Switzerland cannot reach an agreement in a specific case governed by the treaty, a mandatory arbitration proceeding will resolve the dispute.²³²

a. *International judicial assistance in criminal matters*

Switzerland assists the authorities of foreign states in criminal matters in accordance with the Federal Act on International Mutual

²²⁷ OECD, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL art. 26 (2006), (emphasis added).

²²⁸ UBS AG, 2009 WL 1612393, at *9.

²²⁹ Obeid, *supra* note 211, at 5.

²³⁰ *Id.* at 5 n.23; Protocol Amending the Convention Between the Swiss Confederation and United States of America for the Avoidance of Double Taxation with Respect to Taxes on Income, U.S.-Switz., Doc. 2009-21197, Sept. 23, 2009 [hereinafter Protocol].

²³¹ Obeid, *supra* note 211, at 5; Protocol, *supra* note 230, art. 4, ¶ 10(b).

²³² Obeid, *supra* note 211, at 5; Protocol, *supra* note 230, art. 2.

Assistance in Criminal Matters (IMAC).²³³ The IMAC permits assets to be frozen and, if necessary, submitted to relevant foreign officials.²³⁴

International mutual assistance in criminal matters is based on the principles of dual criminality, specificity, and proportionality.²³⁵ Under the dual criminality rule, Swiss courts only employ coercive measures – such as lifting the requirement of bank-client confidentiality – if the act being investigated is punishable under the law of both the requesting state and Switzerland.²³⁶ Under the specificity rule, information gained through the mutual assistance arrangement can be used only for criminal proceedings for which the assistance is provided.²³⁷ Finally, in accordance with the proportionality rule, coercive measures are denied in the case of minor offenses or where there is a risk that the interests of persons not directly involved with the matter will be adversely affected by the proceedings.²³⁸

C. Case Profile: Timeline of Relevant of Events

1. The John Doe Summons

On July 1, 2008, the United States District Court for the Southern District of Florida granted the IRS permission to serve a “John Doe” summons on UBS.²³⁹ A “John Doe” summons is a summons made out to an unidentified defendant or class of defendants, which is referred to in the summons as “John Doe(s).”²⁴⁰

The summons petition was established in response to the indictment of former UBS executive Bradley Birkenfeld, who pleaded guilty to charges of conspiracy to commit offense or to defraud the U.S. on June 19, 2008.²⁴¹ As part of his plea, Birkenfeld admitted that he and other UBS executives aided U.S. taxpayers in evading tax through several means, including: (1) establishing offshore shell companies as nominee owners of

²³³ Swiss Bankers Association, *supra* note 44. The IMAC was entered into on March 20, 1981. *Id.* An unofficial translation of the IMAC is available at http://www.rhf.admin.ch/etc/medialib/data/rhf/recht.Par.0016.File.tmp/sr351-1-e_070101.pdf.

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ *Id.*

²³⁷ *Id.*

²³⁸ *Id.*

²³⁹ Report of AlixPartners at 1, *United States v. UBS AG*, No. 109CV20423, 2009 WL 1612393 (S.D. Fla. 2009).

²⁴⁰ Orlando Fernández, *UBS: Taxing Times for Swiss Banking Secrecy?*, PRAC. L. CO. CROSS-BORDER, Sept. 21, 2009, <http://crossborder.practicallaw.com/8-500-2330>.

²⁴¹ *Id.*

Swiss and Liechtenstein bank accounts to conceal the beneficial ownership of the accounts; and (2) preparing fraudulent tax returns, which concealed the beneficial owners of the accounts.²⁴² The summons identified the John Doe class as U.S. taxpayers who: (1) between December 31, 2002, and December 31, 2007; (2) had signatory or other authority with respect to any financial accounts; (3) maintained at, monitored by, or managed through any Swiss office of UBS, its subsidiaries or affiliates in Switzerland; and (4) for whom UBS AG or its subsidiaries and affiliates did not have in its possession Forms W-9 executed by such U.S. taxpayers, and had not filed timely and accurate Forms 1099 naming such taxpayers and reporting to the IRS all payments made to them.²⁴³ The original summons was believed to apply to approximately 17,000 U.S. taxpayers holding US\$20 billion assets under management in “undeclared” accounts.²⁴⁴

2. *IRS Attempt to Enforce the Summons*

In February 2009, the IRS and the DOJ filed a lawsuit against UBS in an effort to enforce the John Doe Summons and order the disclosure of 52,000 UBS clients with accounts holding a combined US\$14.8 billion in assets.²⁴⁵ UBS opposed the enforcement of the John Doe Summons, arguing the company’s compliance would: (1) directly violate Swiss privacy law provisions regarding the principle of banking secrecy; and (2) overlook the procedure for tax information exchange arranged in the DTA between the U.S. and Switzerland.²⁴⁶ The Swiss government filed an *amicus* brief in support of UBS’ position and noted that the Swiss government expressed its objections to the summons to State Department officials.²⁴⁷

D. *The August 2009 Settlement*

1. *Overview*

On August 19, 2009, the Swiss and U.S. governments published the terms of an agreement (UBS Agreement) intended to end the dispute over the enforcement of a John Doe summons requesting the names of 52,000

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ *Id.*

²⁴⁵ Peter D. Hardy & Thomas E. Zehnle, *Deferred Prosecution Agreement Struck With Swiss Bank UBS as Government Tightens Enforcement Net Around Foreign Accounts*, POST & SCHELL LLC 4-5 (2008), <http://www.postschell.com/docs/publications/419.pdf>.

²⁴⁶ Fernández, *supra* note 240; *see also* Petition to Enforce John Doe Summons, United States v. UBS AG, No. 109CV20423, 2009 WL 1612393 (S.D. Fla. 2009).

²⁴⁷ Amicus brief of the Government of Switzerland at 10, United States of America v. UBS AG, No. 109CV20423, 2009 WL 1612394 (S.D.Fla. April 30, 2009).

UBS clients suspected of tax evasion in the U.S.²⁴⁸ Under the UBS Agreement, Switzerland arranged to release account information relating to approximately 4450 UBS accountholders to the U.S. through the procedure provided by the unrevised DTT between both countries.²⁴⁹ Specifically, the UBS Agreement provides that Switzerland will process the treaty request of the U.S. in an expedited manner, but that UBS will give notice to the accountholders prior to the disclosure of any bank information in order to provide the accountholders with the opportunity to fight the disclosure in Swiss courts.²⁵⁰

UBS has also disclosed the identities of about 250 American UBS clients under a deferred prosecution agreement (DPA) that it signed with the U.S. tax authorities on February 20, 2009.²⁵¹ The DPA was entered into after the DOJ charged UBS with “conspiracy to defraud by impeding the IRS.”²⁵² Under the DPA, UBS also agreed to pay \$780 million to settle civil and criminal charges by the U.S. government that the bank assisted thousands of American clients evade U.S. taxes through the use of Swiss bank accounts.²⁵³

2. Key Terms

It was widely contended by practitioners that a substantial disclosure of names – even if short of the 52,000 requested – was unavoidable.²⁵⁴ The primary issue was whether the disclosure would be conveyed through the established DTT procedure or an alternative method.²⁵⁵ The method of conveyance was consequential because any method other than the DTT would have a greater adverse impact on Swiss banking confidentiality.²⁵⁶

The UBS Agreement contains the following key provisions²⁵⁷:

²⁴⁸ See Agreement Between the United States of America and the Swiss Confederation, U.S.-Switz., Doc. 2009-18745, Aug. 19, 2009, http://www.irs.gov/pub/irs-drop/us-swiss_government_agreement.pdf.

²⁴⁹ Fernández, *supra* note 240. See also Agreement Between the United States of America and the Swiss Confederation, *supra* note 248.

²⁵⁰ *Id.*

²⁵¹ Fernández, *supra* note 240.

²⁵² *Id.*

²⁵³ David S. Hilzenrath & Zachary A. Goldfarb, *UBS to Pay \$780 Million Over U.S. Tax Charges*, WASH. POST, Feb. 19, 2009, at D1.

²⁵⁴ Fernández, *supra* note 240.

²⁵⁵ *Id.*

²⁵⁶ *Id.*

²⁵⁷ *Id.*

- The U.S. will file a request under the existing DTT regarding American UBS account-holders (estimated 4450) meeting a set of criteria listed in a currently confidential annex to the agreement (the Treaty Request). Then, the government, acting through the Swiss Federal Tax Administration will make a decision, within 90 days of the receipt of the Treaty Request, on the first 500 names and the remaining names on a continuing basis for up to 360 days (*Article 1*).
- The U.S. and Swiss governments will sign a new protocol to their DTT by September 30, 2009 (*Article 2*).
- The U.S. will dismiss its enforcement action relating to the John Doe summons and not pursue reinforcement while the agreement remains in force. It will also completely withdraw the summons in relation to: (1) accounts not covered by the December 31, 2009 Treaty Request; and (2) subject to satisfactory disclosure by UBS, accounts covered by the request no later than 370 days after the signing of the agreement (*Article 3*).
- The compliance timetable establishes that UBS must process: (1) the first 500 cases sixty days after receipt of the Treaty Request by the SFTA; (2) the remaining cases referenced in the Annex to the agreement within 180 days; and (3) all outstanding cases within 270 days (*Article 4*).
- The agreement authorizes either party to take “rebalancing measures” if, 370 days after signing, “the actual and anticipated results differ significantly from what can reasonably be expected.” These measures may not go beyond preserving the legal situation of either party, which existed immediately prior to such measures being taken, or impose additional obligations on UBS (*Article 5*).

E. *Swiss Court Ruling: UBS Client Wins Case on Transfer of Tax Data to U.S.*

1. *Judgment*

In January 2010, two Swiss courts ruled that Switzerland’s financial regulator, the Swiss Financial Market Supervisory Authority (FINMA), broke the law when it ordered UBS to surrender data to U.S. authorities on nearly 300 clients suspected of evading taxes.²⁵⁸ The ruling

²⁵⁸ Lynnley Browning, *Swiss Back Away from Deal to Give Names of Rich UBS Clients to U.S.*, N.Y. TIMES, Jan. 27, 2010, at 3.

came as the result of a test case brought on behalf of a U.S. citizen that challenged the UBS Agreement and specifically, Switzerland's commitment to disclose details of suspected tax avoiders.²⁵⁹ Though the full effects are not yet clear, the landmark ruling may destabilize the agreement for Switzerland to communicate information regarding as many as 4,450 UBS accounts to the U.S. and could impede the concentrated global effort to crackdown on overseas tax evasion.²⁶⁰

In a sixty-page ruling, the Federal Administrative Court in Bern said that failure to complete a tax form did not constitute fraudulent behavior, regardless of whether large sums of money were involved. "Provided the taxpayer did nothing more than not declare income, an account or return the form W-9, consequently committing tax evasion under Swiss law, he hasn't acted fraudulently," the five judges wrote.²⁶¹ Additionally, the Court ruled that because the government and the parliament are the only institutions with the authority to implement state of emergency laws, FINMA transgressed its mandate by facilitating the UBS Agreement.²⁶² The Court concluded that tax evasion - not tax fraud - was at issue and, therefore, traditional Swiss banking secrecy rules applied. As of the submission of this Note, FINMA has not announced if it will appeal the ruling to the Swiss Supreme Court.²⁶³

2. Effect of Court Ruling on Swiss-U.S. Tax Agreement

While it is too late to stop the transmission of certain client data, the ruling from Bern could influence the course of future cases, as Switzerland remains embroiled in disputes regarding tax evasion and the implementation of the UBS Agreement.

The international repercussions of the U.S.-UBS dispute have the potential to be grave; not only for Switzerland and its long-standing tradition of bank secrecy, but also for the global existence of banking secrecy laws. A seemingly nominal success by U.S. tax authorities could

²⁵⁹ *UBS: Swiss Court Upholds US Taxpayer's Appeal in Test Case*, FRANCE 24, Jan. 22, 2010, <http://www.france24.com/en/20100122-ubs-swiss-court-upholds-us-taxpayers-appeal-test-case>.

²⁶⁰ Heaven, *supra* note 184.

²⁶¹ *Id.*; U.S. taxpayers use the W-9 form to declare foreign bank accounts. *Id.*

²⁶² Elena Logutenkova, Joseph Heaven & Wille Klaus, *Swiss Regulator Broke Law on UBS Client Disclosure (Update 3)*, BLOOMBERG, Jan. 8, 2010, <http://www.bloomberg.com/apps/news?pid=20601085&sid=aMAMWB.hmjY8>.

²⁶³ *Chris v. Nicholson, Swiss Regulators' Demand of UBS Client Data Found Illegal*, N.Y. TIMES, Jan. 8, 2010, <http://www.nytimes.com/2010/01/09/business/global/09ubs.html>.

encourage tax authorities in a multitude of jurisdictions to pursue a similar strategy.²⁶⁴ For example, tax experts report that Germany and France are closely monitoring the progression of the UBS Agreement and may employ similar actions against their own banks if the U.S. emerges victoriously.²⁶⁵

UBS itself has warned of the potential for ensuing actions by other states in its latest filing: "Following disclosure of the U.S. cross-border matter, it is possible that tax or regulatory authorities in various jurisdictions will focus on the cross-border wealth management services provided by UBS and other financial institutions..."²⁶⁶ Additionally, tax experts profess that even if Switzerland continues to retain some of its privacy rules, the country and other smaller jurisdictions will feel compelled to increasingly cooperate with Western tax authorities when prompted to avoid costly (and potentially demising) litigation.²⁶⁷

Finally, IRS Commissioner Doug Shulman said in a TV interview that the agreement "blows a big hole in bank secrecy."²⁶⁸ As he explained, U.S. tax authorities have never before been able to gain access to secret bank accounts in Switzerland, and now, that dynamic could change forever.²⁶⁹

The ruling out of Bern creates a flicker of hope for those seeking privacy on the Swiss shores. However, proponents of Swiss banking secrecy cannot yet declare victory. The Swiss government is scrambling to rescue the Agreement it worked so hard to complete. Switzerland and the U.S. said in an annex to the UBS settlement agreement that U.S. citizens who benefited from offshore company accounts with UBS between 2001 and 2008, as well as U.S.-based clients of UBS who failed to disclose accounts or deposits in excess of 1 million CHF (US\$960,000), could be covered by the agreement if there is a reasonable suspicion of "tax fraud or the like."²⁷⁰ However, the court called the annex an MOU that did not alter the 1996 DTT.²⁷¹ Of the 4450 cases, 250 accounts involved fraud, including the use of false documentation and a "scheme of lies," and the remaining 4200 were situations of "continued serious tax offenses."²⁷²

²⁶⁴ Stonestreet, *supra* note 68.

²⁶⁵ *Id.*

²⁶⁶ *Id.*

²⁶⁷ *See id.*

²⁶⁸ Kathleen Pender, *UBS Case Weakens Swiss Bank Secrecy*, SFGATE, Aug. 23, 2009, http://articles.sfgate.com/2009-08-23/business/17178483_1_swiss-bank-switzerland-s-largest-bank-swiss-government.

²⁶⁹ *Id.*

²⁷⁰ Heaven, *supra* note 184.

²⁷¹ *Id.*

²⁷² *Id.*

At present, the Swiss government is planning to seek retrospective parliamentary approval for the UBS Agreement after it amends its text to “remedy the shortcomings” highlighted by the Federal Administrative Court.²⁷³ In its holding, the Court proclaimed the UBS Agreement ignored aspects of Swiss banking secrecy rules, including safeguards that prevent the government from surrendering files to foreign tax authorities except in cases of deliberate fraud.²⁷⁴ Parliamentary approval would elevate the status of the UBS Agreement from simply a “mutual agreement” to that of a treaty and would thus, give the Agreement official legal standing in Switzerland.²⁷⁵ The IRS said it “ha[s] every expectation that the Swiss government will continue to honor the terms of the agreement.”²⁷⁶

VI. CONCLUSION

Prompted by the UBS tax evasion scandal and inflamed by the poor global economic climate, the Swiss government has been tasked with reexamining its banking industry regulations.²⁷⁷ For some, Swiss banking secrecy is the staple of a strong offshore economy meant to protect the innocent rather than shield the guilty.²⁷⁸ For others, it fosters a dubious, even harmful, institution that must be politically challenged.²⁷⁹

An increasing number of voices are speaking up against banking secrecy, which, under current Swiss law, can only be bypassed if a client is suspecting of defrauding tax authorities, rather than simply not declaring all assets.²⁸⁰ As reported in a March 2009 *Time* article, fifty-six percent of Swiss citizens support aiding foreign countries in their quest to identify tax evaders, up from twenty-percent in 2008.²⁸¹ Additionally, some industry insiders agree that changes to the law might be inevitable to avoid

²⁷³ Matthew Saltmarsh, *Swiss to Submit Revised UBS Tax Deal to Parliament*, N.Y. TIMES, Feb. 24, 2010, <http://www.nytimes.com/2010/02/25/business/global/25tax.html>. The Swiss Justice Ministry expects to complete the text amendments in March of 2010, but to date has not specified the scope of the amendments or any particulars of what they will involve. *Id.* Additionally, the Swiss government announced plans to bill UBS 1 million Swiss francs, or US\$928,000, to cover part of its costs related to the case and UBS has agreed to pay. *Id.*

²⁷⁴ *Id.*

²⁷⁵ *Id.*

²⁷⁶ Heaven, *supra* note 184.

²⁷⁷ Helena Bachmann, *The Swiss Question Their Once Proud Banks*, TIME, Mar. 5, 2009, <http://www.time.com/time/business/article/0,8599,1883255,00.html>.

²⁷⁸ Ronald Holland, <http://www.ronaldholland.com/mystiqueofswitzerland.htm>.

²⁷⁹ *Id.*

²⁸⁰ Bachmann, *supra* note 277.

²⁸¹ *Id.*

continued pressure from abroad. But, whether the current uproar will permanently weaken confidence in the banking sector and ultimately warp the seventy-five-year-old banking secrecy law remains to be seen.²⁸²

²⁸² *Id.*